What does your Income Protection Policy Offset Clause say?

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In Carolyn Philips (nee Durrand) v Tower Australia Ltd Einstein J. of the Supreme Court of New South Wales held that the defendant insurer was not entitled to offset disability support pension payments received by the plaintiff against disablement benefits payable under an income protection insurance policy. His Honour also commented on the calculation of interest payable on past benefits pursuant to s57 of the Insurance Contracts Act 1984 (Cth).

What action should be taken?
Claims where Disability Support Pension payments are being offset should be reviewed in light of this decision paying close attention to the specific terms of the “offset clause” in the policy. The decision should also be taken into account when conducting policy upgrades and reviews.

BACKGROUND
The plaintiff lodged a claim for past benefits under the policy from the date of her disablement in 1999 and continuing. The insurer agreed that benefits were payable, and the dispute in this instance was limited to the following issues:
1. Whether the insurer was entitled under the policy to offset social security benefits received by the plaintiff against the past insurance benefits.
2. The date from which interest was payable on the past insurance benefits, and the manner in which interest was to be calculated.

OFFSET
The policy provided that the defendant was entitled to deduct “other disability income” from the insurance payments. This was relevantly defined in the policy as follows:

Other Disability Income is the monthly income received by you during Disability from: ...

(b) Workers compensation, Workcare, accident compensation or any other similar state or federal legislation
The plaintiff had qualified to receive the disability support pension (DSP) and was in receipt of payments pursuant to s94 of the Social Security Act 1991 (Cth) (SSA).

The question to be determined was therefore whether DSP payments could be characterised as “similar” to Workers Compensation, Workcare or Accident Compensation (to be collectively referred to as Accident Compensation Legislation).

THE DECISION

His Honour held that the provisions of s94 of the SSA were “sufficiently distinguishable” from the concept of accident compensation legislation. Thus payment of the DSP did not fall within the definition of “other disability income”, and the insurer was not entitled to offset the DSP against the past insurance benefits.

His Honour did not set out detailed reasoning for his decision. He identified that the main similarity between the SSA and accident compensation legislation is that payments are made to a person by reason of their inability to work due to disability. He noted that there were “obvious differences” between the two classes of legislation, but did not set out the precise nature of those differences.

However, the comments made by His Honour suggest that he viewed the major difference as being whether a benefit was payable due to an accident. He noted that the plaintiff had not been injured as a result of an accident, and her workers compensation claim had been denied. He concluded that:

“any relevant benefits would have to arise by reason of accident compensation schemes or statutory accident compensation schemes or the like.”

ANALYSIS

His Honour’s conclusion as to which benefits could be offset does not seem to significantly further the definition provided in the policy.

Legislation which clearly falls within the bounds of accident compensation legislation will not always require an accident to occur in order for benefits to be payable. For example, workers compensation legislation requires the employee to establish that their illness or injury was caused by their employment, but it does not have to arise as a result of an accident, per se.

It is possible that the difference to which His Honour was alluding is that accident compensation legislation places strict limitations on when benefits will be paid based on the manner in which the injury or illness was sustained. For example, in general terms, workers compensation benefits are only paid in respect of a work related injury. Transport accident compensation will only be paid for transport accidents. However, payment of the DSP is not limited by how the injury or illness arose – it only requires a physical impairment that results in an inability to work.

His Honour also gave some consideration to the offset provisions in the SSA. Part 3.14 of the SSA provides that a “compensation affected payment” (which includes the DSP) may be reduced, rendered not payable or require repayment if the person has received a relevant form of compensation.

His Honour set out subsections 17(2) and (2A) of the SSA which define what forms of compensation the Commonwealth is entitled to offset. His Honour did not come to any conclusions regarding the application of these sections to the plaintiff’s case as this was not in issue before him. However, it is possible that the application of these sections influenced his Honour’s determination.

The insurance benefits that would now be payable by the insurer are likely to fall within the definition of compensation set out at subsection s17(2)(d) of the SSA, being:

- any other compensation or damages payment… that is made wholly or partly in respect of lost earnings or lost capacity to earn resulting from personal injury.

On the basis of this section, it would seem that the Commonwealth is entitled to offset the past insurance benefits and seek repayment of the DSP. However, s17(2A) provides that s17(2)(d) will not apply if:

- the recipient has made contributions towards the payment such as insurance premiums – which the plaintiff had in this instance; and
- the policy does not provide for the offset of social security benefits.

As His Honour found that the policy did not allow the offset of social security benefits, it seems that s17(2)(d) will not apply to the past disability payments. The Commonwealth therefore will not be entitled to offset the past insurance benefits against the DSP payments.

In coming to his decision, it is possible that His Honour was aware of this potential outcome and the fact that the only real winner from a judgment in favour of the insurer would have been the Commonwealth.

In any event, it is important to note His Honour’s comment that “the question of construction is a close one”. This suggests that a different judge reviewing even a slightly different policy wording could come to a different conclusion. Furthermore, the judgment is confined to the DSP. Other social security benefits may be considered sufficiently similar to accident compensation legislation to fall within the “other disability income” definition.

Nonetheless, if an insurer wishes to ensure that social security benefits can be offset against the benefits payable under its policies, it would be prudent to specify this in the policy.

INTEREST

The parties agreed that interest was payable on the past benefits pursuant to s57 of the Insurance Contracts Act. However, they disagreed on the date from which it was payable, being the date from which “it was unreasonable for the insurer to have withheld payment”, as set out in s57. As His Honour noted, this was a determination which had to be made having regard to the particular circumstances of the case.

The plaintiff submitted that she was disabled from 2 November 1999, and 30 days was ample time for the insurer to establish that the claim was genuine. The plaintiff therefore sought interest from 3 December 1999.
The insurer submitted that three months was a reasonable time for it to review and investigate the claim. In addition, the insurer noted that it had not been in possession of any evidence of the plaintiff’s entitlement to benefits until it received a report from the plaintiff dated 8 November 2001. However, as His Honour noted, the plaintiff had not provided evidence at an earlier date because the insurer had wrongfully asserted that the policy had lapsed.

His Honour stated that it was not relevant whether the insurer acted bona fide in denying the claim. The relevant consideration was what time it was reasonable for the insurer to complete its investigation of the claim.

However, His Honour pointed to a long line of authority to the effect that “no man can take advantage of his own wrong”. His Honour concluded that the insurer could not rely on the absence of medical evidence prior to 2001 to avoid paying interest because that absence was due to its fault in wrongfully denying the plaintiff’s entitlement to claim.

It therefore seems that if an insurer takes steps to avoid a policy or deny a claimant’s entitlement to claim which causes a delay in provision of evidence by the claimant, and a court subsequently finds that this was wrongfully done, it is irrelevant that the insurer may have acted bona fide in taking that action. It will still be open for the court to find that interest is payable from prior to the submission of evidence by the claimant.

By contrast, if a claimant lodges a claim and the insurer’s denial of the claim is not bona fide, interest will not necessarily be payable from the date of the first denial if it is shown that it was not reasonable for an insurer to admit the claim at that date.

In this case, His Honour found that a reasonable time for the insurer to complete its investigation of the claim was 30 days, although noted that no evidence had been adduced by either side on this issue. Interest was therefore payable from 3 December 1999.

The parties proposed alternative methods of calculating interest, although again no expert actuarial evidence was called in support of these competing methods. Rather than coming to a conclusion about which method was correct, His Honour took the “fair approach” of averaging the two calculations and awarding interest at that value.

CONCLUSION

The issue of an insurer’s entitlement to offset social security benefits is one that frequently arises in the context of income protection claims. There has not previously been a court determination on this issue, and current and future claimants may well argue that Philips provides us with a definitive answer.

However, it is important to note that the limitations of the judgment. Firstly, Einstein J. has expressly noted that the issue of construction was close. The findings in this case will not necessarily apply to policy definitions with a different wording. Secondly, the decision relates specifically to the DSP payable pursuant to s94 of the SSA. Once again, consideration of a different social security benefit may result in a different outcome.

However, it should be noted that a policy which does allow an offset of social security benefits may result in the insurance payments coming under the definition of “compensation” under the SSA. This may in turn give rise to an entitlement by the Commonwealth to seek recovery of the social security benefits either from the claimant or directly from the insurer.

Although not an issue in Philips, the ability for an insurer to offset lump sum payments received under legislation can also be problematic. If insurers wish to offset for such amounts, the policy wording should address both the entitlement and the methodology for applying such an offset.

In terms of s57 of the ICA, it remains the position, as set out in Diosdado Sayson v Kellogg Superannuation Pty Ltd & Anor,1 that the courts will determine when interest is payable by reference to what would have been a reasonable time for the insurer to complete its investigations. The case indicates the importance for insurers to provide the courts with evidence regarding the reasonableness of the time taken to assess the claim.

Insurers should also note that they cannot rely on the plaintiff’s delay in the provision of evidence in support of the claim if that delay was caused by the insurer’s wrongful conduct in denying the claim or avoiding the policy.

NOTES

1 [2008] NSWSC 1047. (‘Philips’)
2 Above n1, para [18].